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THE GEORGIA INDIVIDUAL TAX : CURRENT STRUCTURE AND IMPACT OF PROPOSED CHANGES

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Why should Georgia consider making changes to a tax structure that appears to perform well? Generally, because we seek to ensure that the state will continue to proceed in the "right" direction. Second, the tax is so important to the state; of the revenue tools that Georgia uses, the individual income tax is the most productive, yielding over 45 percent of the state's 1997 tax revenue compared to 37.5 percent from the sales tax. Third, the individual income tax has had the same basic structure for over fifty years. Perhaps we should examine where the tax fits into our overall state revenue structure and what changes, if any, are needed. The passage and approval this year of House Bill 1162, which raises the personal exemption amounts closer to the level used for federal income taxes, confirms that some changes appear to be desirable. But is that change sufficient, or do we need to make other modifications, or even totally eliminate this revenue tool?

This paper provides information to assist in answering that question by evaluating the merits of four options for change in Georgia's individual income tax. First, the paper begins with a discussion of how different tax structures affect the distribution of tax burden. The paper then presents comparative information regarding state income taxes. We conclude with an analysis of four options for change to Georgia's tax structure: (1) increase the standard deduction to correspond to the federal income tax amounts; (2) eliminate the retirement income exemption currently permitted in Georgia; (3) eliminate the top tax bracket of 6 percent; and (4) eliminate the income tax completely.

How do tax structures affect the distribution of tax burdens?

How to judge the income tax. A number of considerations affect the desirability of a tax. The income tax ranks favorably compared to alternative revenue tool in some respects, but poorly in other ways. Table 1 lists different criterion for judging a tax and offers a comparison between the sales tax and the income tax. A discussion of each measure follows the table.

Table 1. Comparison of the Individual Income Tax and Sales Tax

Criteria	Income Tax	Sales Tax
Horizontal Equity--Taxation of Equal Individuals	H	M
Vertical Equity--Taxation of Unequal Individuals	L-H	L
Taxation During Business Cycles	L-H	L-H
Effect on Economic Decisions	H	L
Deductibility at Federal Level	H	L
Compliance Costs	L	M
Administrative Costs	L	L
Effect During Inflationary Years	L-H	H

H=High; L=Low; M=Medium

- *Horizontal Equity--Taxation of Equal Individuals.* People generally agree that individuals who have equal ability to pay taxes should be treated equally under the tax laws. When an income tax treats all "equal" individuals the same, the tax scores high in terms of horizontal equity. However, states often use the income tax to give special preferences to certain groups or certain income types (such as retirement income). When this special treatment occurs, the income tax is not judged as favorably in terms of horizontal equity. To illustrate this shortcoming, consider two single individuals over the age of 65, both with income of $20,000. One person earns $20,000 by working, while the other draws retirement income of $20,000. The latter receives the benefits of the $12,000 retirement income exclusion, while the former's entire income is subject to taxation. The retiree pays $84.50 or .4 percent of his annual income in income tax, while the wage earner pays $758 in taxes. As another example, consider Tennessee's income tax. Tennessee only taxes dividends from stock and interest income from certain sources. For Tennessee residents, interest income from a bank chartered in Georgia would be subject to taxation, while interest income from a bank chartered in Tennessee would be tax-exempt. In both examples, tax inequities exist between individuals in the same income brackets, causing the taxes to score unfavorably in terms of horizontal equity.

- *Vertical Equity--Taxation of Unequal Individuals.* The rating of an income tax in terms of vertical equity is open to debate. Most people generally agree that a progressive tax, i.e., one with lower taxes on the poor, is preferred. However, varied opinions exist as to how high-income households should be taxed. The arguments in favor of higher effective tax rates for high income household are, first, higher taxes reduce the gap in after-tax incomes, and second high-income households have a greater ability to pay taxes. The counter argument is that a high level of progressivity may discourage high-income individuals from living in or from locating their businesses within the state. The degree to which state taxation enters into an individual's location decisions is open to question, however.

- *Taxation During Business Cycles.* During economic expansions, the revenues from an income tax grow, with no changes needed to the structure of the tax. Thus, one advantage of an income tax is that no change is needed to tax laws to provide funds for the increased demands of a growing economy--the tax revenues grow as personal incomes grow. During economic downturns, however, total revenues grow more slowly or may even decline because incomes

decrease during economic downturns. From an individual's perspective, this characteristic of the income tax is desirable because the individual's tax bill decreases when one's income decreases. However, if the need for state revenues remains constant or grows during these downturns (e.g., because of increased welfare payments), this characteristic of the income tax is a disadvantage because the state must either find new sources of revenue or change the income tax structure to obtain more revenues.

- *Effect on Economic Decisions.* Taxes provide an incentive to alter an individual's economic decisions, thereby reducing the individual's satisfaction. The income tax is thought to discourage at least some individuals from working or saving. However, empirical evidence suggests that the state income tax does not materially affects an individual's work decisions. Special provisions can have a large effect on economic decisions, e.g., exemption from or reduced taxation of income on certain investments; such as municipal bonds, investments in certain areas, etc. However, in the absence of special provisions, an income tax can be relatively neutral in its effects on economic decisions, reducing the distortions in the economy.

- *Deductibility at the Federal Level.* Unlike other taxes imposed at the state level, the state income tax is deductible for federal income tax purposes, which shifts some of the overall tax burden from Georgia's residents. However, this benefit accrues to taxpayers who itemize on their federal income tax return.

- *Compliance and Administrative Costs.* The income tax imposes a compliance cost on each individual who earns income within the state, as well as on the businesses that employ those individuals. Conversely, the sales tax only imposes compliance costs on businesses. Furthermore, administering the income tax can be cumbersome and expensive for the state.

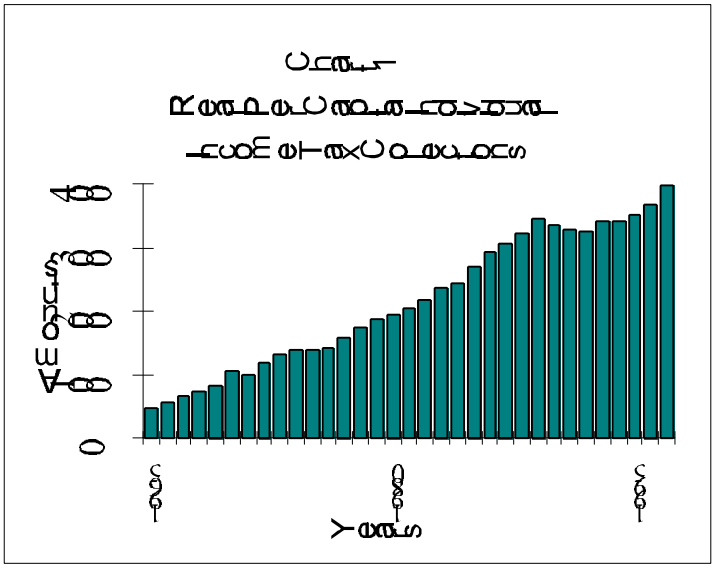
- *Effect During Inflationary Years.* Under Georgia's income tax system, inflation results in increased income tax bills. Furthermore, many taxpayers move into higher tax brackets as income increases. Even if an individual's income grows in line with inflation, taxable income increases by more than the rate of inflation because the standard deduction and personal exemption amounts remain constant. Thus, income tax bills grow at a higher rate than income. Some states, such as South Carolina, consider inflation's effects in their individual income tax system and annually adjust their tax brackets, their personal exemptions and their standard deduction to eliminate the effects of inflation on the individual's tax bills. Such a system, however, increases both compliance and administrative costs.

How important is the individual income tax to Georgia and its neighbors?

Forty-one states levy an income tax on a broad definition of income (profits, wages and salaries, interest, dividends); two states levy an income tax on certain types of capital income (interest and dividends); and 7 states eschew the income tax in favor of a combination of other revenue instruments, primarily the sales tax.

Georgia introduced the individual income tax in 1929, when only 14 other states imposed the tax. Since the early days of the individual income tax, the state's reliance on the tax has grown. In 1970, this tax comprised 20.4 percent of state government tax revenue. By 1997, that percentage had

risen to 45.1 percent. Chart 1 shows the growth in real (inflation-adjusted) per capita individual income tax collections from 1965 through 1997. Although the per capita amounts grew steadily during the period 1965 through 1989, 1990 began a period of slower growth, in part due to the economic recession.



Importance of the Tax. Georgia relies more heavily on the individual income tax as a source of state revenues than all of its neighbors except North Carolina (Table 2). In addition, Georgia's per capita income tax revenue exceeds the national average of all states by more than $70, but is less than the U.S. average for the states which levy an income tax on a broad base.

Table 2. State Individual Income Taxes - 1996

State	As a % of Total Tax Revenue	As a % of Own-Source Revenue [1]	As a % of General Revenue [1]	Revenue Per Capita
U.S. Average [2]	32.0	24.4	17.4	506.07
U.S. Taxed Average [3]	37.8	31.2	20.7	620.14
Georgia	41.2	32.8	23.1	577.17
Alabama	30.0	20.9	14.5	369.27
Florida	0.0	0.0	0.0	0.00
North Carolina	41.5	34.5	24.6	673.10
South Carolina	35.5	25.6	17.7	490.29
Tennessee	1.9	1.5	0.9	21.51

[1] Own-source revenue includes taxes, fees, or other revenues that the state collects on personal or business transactions or property held within the state. General revenue includes all revenues including transfers from other governments, primarily the federal government.

[2] U.S. Average is the average based on data for all 50 states and the District of Columbia.

[3] U.S. Taxed Average is the average based on data for the 41 states which levy an income tax based on a broad definition of income and the District of Columbia.

Source: U.S. Bureau of the Census; <http://www.census.gov/govs/www/state.html>; (accessed 02-13-98).

How do the structures of states' individual income taxes differ?

Components of a tax system. Four primary components comprise the structure of most individual income tax systems: (1) tax bases (e.g., which income types are taxed--wages, interest income, dividend income, etc.), (2) personal exemptions and standard or itemized deductions; (3) tax rates; and (4) tax credits. To evaluate any tax structure, all components must be considered. For example, one state may have very low tax rates, combined with low personal exemptions and standard deductions, while another state might have higher tax rates but more generous personal exemptions and standard deductions.

Tax bases. Georgia bases its calculation on federal adjusted gross income (FAGI); twenty-six other states, including Alabama, also use this basis for their income tax calculation. Seven states, including South Carolina and North Carolina, base their tax calculation on federal taxable income (FTI), which means that those states automatically adopt the federal personal exemption and standard deduction amounts. For these states, any changes to the federal income tax regulations, including changes to personal exemptions and standard deduction amounts, automatically impact the states' individual income tax revenues. For Georgia's other two neighbors, state income taxes are not an important revenue source. Tennessee taxes only selected dividend and interest income; Florida levies no income tax.

Personal exemptions, standard deductions, and tax rates. Most individual income tax systems include both a personal exemption and a standard deduction, the amounts of which vary based on filing status. Pennsylvania is the only state that taxes a broad range of income and allows neither personal exemptions nor a standard deduction, although a few states allow for only personal exemptions.[1] When states allow standard deductions, the taxpayer deducts that amount from income before calculating the tax liability. For personal exemptions, some states allow a tax credit for the taxpayer and each dependent, while other states provide for a deduction from income before the tax calculation. Practices regarding tax rates also vary widely. States use as few as one tax rate and as

[1]Pennsylvania's income tax code contains a provision for poverty relief, which effectively excludes from taxation those taxpayers with extremely low income.

many as ten rates for different income levels, with tax rates ranging from 0.04 to 12 percent of taxable income. Table 3 presents information for single taxpayers applicable to Georgia and its neighbors.

Recent Changes to Georgia's Structure. Georgia adopted new personal exemption amounts for tax year 1998 which are now roughly in line with the federal exemptions allowed. Table 4 summarizes the effects of these changes, by filing status and for dependents. For a family of four with a taxable income of $12,800 or more, the new increase in personal exemptions represents a savings of $168 a year in Georgia taxes. Based on full-year residents and 1996 taxable income levels, we estimate this change reduced 1998 income tax revenues by approximately 5 percent or $205 million.[2]

Georgia's 1998 Tax Structure. The standard deduction varies by filing status, as do thresholds and upper limits for the different tax rates (Table 5). Other additions to and deductions from income are allowed, based on differences between the Georgia and federal tax codes. One difference is the deduction for retirement income of up to $12,000 allowed by Georgia's code. Currently, Georgia has six tax rates ranging from 1 percent to 6 percent.

Tax credits. Tax credits reduce the tax liability dollar for dollar and provide tax relief to selected groups of individuals. Among the most widely used are credits for child care, the elderly, low-income households, and income taxes paid to other states. Although tax credits may have little overall impact on taxpayers, they can make a significant difference in the tax burdens of the favored group and, as such, introduce distortions in terms of equity. Tax credits offered throughout the southeastern states vary widely. Georgia follows the practice of the federal government and provides a tax credit for lower-income taxpayers. In addition, the state offers a tax credit for creation of certain jobs and investments (manufacturing equipment, etc.) within the state.

[2]To obtain this estimate, the Fiscal Research Program, Georgia State University, used 1996 individual income tax information for full-year residents to simulate the tax liability both before and after the tax change. To obtain the estimated effect for 1998, the amounts were then increased based on the growth rate in personal income within the state for 1997 and the rate predicted by the Economic Forecasting Center, Georgia State University.

Table 3. Tax Structures - Georgia and Surrounding States Effective for Tax Year 1997

State	Tax Basis [1]	Personal Exemptions		Maximum Standard Deduction	Tax Brackets and Rates				
						Bottom Bracket		Top Bracket	
		Taxpayer	Dependents		# of Brackets	Percentage Range	Amount Range	Percentage Range	Amount Range
Alabama	FAGI	$1,500	$300	$2,000	3	2%	$0-500	5%	> $3,000
Georgia	FAGI	$1,500	$2,500	$2,300	6	1%	$0-750	6%	> $7,000
North Carolina	FTI	$2,650	$2,650	$4,150	3	6%	$0-12,750	7.75%	> $60,000
South Carolina	FTI	$2,650	$2,650	$4,150	6	2.5%	$0-2,280	7%	> $11,401
Tennessee	CI	n.a.	n.a.	n.a.	1	6%	-----	6%	-----

[1] FAGI=federal adjusted gross income; FTI=federal taxable income; CI=selected components of capital income.

Table 4. Personal Exemptions

Filing Status	Georgia 1997 Amounts	Georgia 1998 Amounts	Federal 1997 Amounts [1]
Single	$1,500	$2,700	$2,650
Married, Joint Filers	$3,000	$5,400	$5,300
Married, Separate Filers	$1,500	$2,700	$2,650
Heads of Household	$1,500/$3,000	$2,700/$5,400	$2,650/$5,300
Dependents	$2,500	$2,700	$2650

[1] Although Georgia's personal exemption amount exceeds the 1997 federal personal exemption, the federal personal exemption increases annually to eliminate the effects of inflation.

Table 5. Structure of the Individual Income Tax in Georgia - 1997*

Filing Status	Standard Deduction	Income Ranges to Which Rates Apply					
		1%	2%	3%	4%	5%	6%
Single	$2300	$0-750	$750-2250	$2250-3750	$3750-5250	$5250-7000	over $7000
Married, Joint Filers	$3000	$0-1000	$1000-3000	$3000-5000	$5000-7000	$7000-10000	over $10000
Married, Separate Filers	$1500	0-$500	$500-1500	$1500-2500	$2500-3500	$3500-5000	over $5000
Head of Household	$2300	0-$1000	$1000-3000	$3000-5000	$5000-7000	$7000-10000	over $10000

*****Table 4 shows the personal exemption amounts, by filing status. Additional exemptions of $700 each are allowed for taxpayers who are 65 or older and taxpayers who are blind at the close of the taxable year.

Analysis of four options for reform

We consider four possible changes to the Georgia individual income tax. For the analysis, only full-year residents were considered using the current law that incorporates the 1998 changes in personal exemption amounts.

Option #1: **Increase the standard deduction of all filers to the federal standard deduction amounts**

This change is a logical compliment to the increase in the personal exemption enacted through House Bill 1162 in early 1998. Table 6 shows the current Georgia and federal standard deduction amounts. Increasing the standard deduction amount to the federal levels results in approximately a 3.5 percent, or $137 million, decrease in personal income tax receipts for 1998 and in lower tax burdens for all filers (Table 7). The largest benefit goes to those taxpayers with federal AGI between $10,000 and $25,000, resulting in a somewhat more progressive tax than the current tax system. Individuals who continue to itemize on their federal income tax return will not benefit from this change. This consequence of adopting the federal standard deduction amount for Georgia results in a negligible effect on individuals in higher income categories. Further, if individuals are currently not eligible for the low-income tax credit or do not file for the credit, this increased deduction amount will decrease the number of individuals filing taxes, leading to administrative savings due to a reduction of the paperwork and audit processing.

Table 6. Standard Deduction Amounts - Georgia and Federal

	Georgia Amount	Federal Amount
Singles	$2,300	$4,150
Married/Jointly	$3,000	$6,900
Married/Separately	$1,500	$3,450
Head of Household	$2,300	$6,050

Table 7. Taxes Paid as a Percentage of Federal Gross Income

Current Law, Options 1, 2, 3

(All numbers in thousands except percentages)

Original Federal AGI Class		Federal AGI	Current Law - Taxes Paid		Option 1 - Taxes Paid		Option 2 - Taxes Paid		Option 3 - Taxes Paid	
			Amount	% of Federal AGI	Amount	% of Federal AGI	Amount	% of Federal AGI	Amount	% of Federal AGI
Under	$1,000	$12,557	$-2,589	-20.6	$-2,591	-20.6	$-2,531	-20.2	$-2595	-20.7
$1,000	$5,000	449,116	-8,639	-1.9	-8,650	-1.9	-8,297	-1.9	-8,644	-1.9
$5,000	$10,000	1,323,128	-3,206	-0.2	-5,905	-0.5	1,060	.1	-3,328	-0.3
$10,000	$15,000	2,111,466	18,009	0.9	11,199	0.5	28,404	1.3	17,641	0.8
$15,000	$25,000	6,117,506	112,711	1.8	88,550	1.4	135,085	2.2	103,445	1.7
$25,000	$35,000	7,453,228	199,191	2.7	172,511	2.3	215,716	2.9	177,553	2.4
$35,000	$50,000	12,979,830	410,069	3.2	379,255	2.9	428,088	3.3	357,868	2.8
$50,000	$75,000	20,234,793	715,953	3.5	694,879	3.4	733,297	3.6	615,013	3.0
$75,000	$100,000	12,024,179	464,322	3.9	459,498	3.8	469,410	3.9	394,827	3.3
Over	$100,000	32,984,177	1,547,952	4.7	1,544,407	4.7	1,550,634	4.7	1,298385	3.9
Total:		$95,689,979	$3,453,775	3.6	3,333,153	3.5	3,550,866	3.7	2,950,164	3.1

Source: GSU simulations based on 1996 individual income tax data from the Georgia Department of Revenue, under 1998 law.

Option #2: **Eliminate the retirement income exemption allowed within the state**

The retirement income exemption is currently $12,000 and applies to retirement income of taxpayers age 62 or older or who are permanently and totally disabled (which would otherwise be included in Georgia taxable income). Married individuals filing jointly are allowed twice the exemption amount, provided both meet the age and/or disability requirement.

Eliminating the exemption goes against current trends in state taxation as many states look for ways to decrease the tax burden on the elderly. As Georgia's population ages, however, more taxpayers will take advantage of this exemption and the associated costs will escalate. This method of providing relief to the elderly does little to benefit those that need the most help--the elderly poor--as they receive either all or the bulk of their income from social security benefits on which they would not pay income taxes. Removing the $12,000 retirement income deduction would have a small effect on state revenues and is estimated to raise 1998 income tax revenue approximately $110 million or 2.8 percent. The increase in taxes would be felt mainly by taxpayers with adjusted gross income ranging from $10,000 to $25,000 (Table 7).

Option #3: **Eliminate the top bracket (6%)**

Eliminating the top bracket while retaining the same lower threshold income levels for the 5 percent tax bracket would reduce taxes for anyone currently in the 6 percent bracket. Table 8 shows the threshold levels of the 5 percent bracket.

Table 8. Threshold Levels - 5 Percent Bracket

Filing Status	Threshold Levels
Singles	$5,250
Married/Jointly	$7,000
Married/Separately	$3,500
Head of Household	$7,000

This proposed change mirrors similar changes enacted throughout the nation during recent years. The prosperity and growth in personal income during the 1990's resulted in record collections of individual income tax receipts for a number of states. The subsequent budget surpluses prompted a number of states to slash their individual income tax rates and, in some cases, eliminate tax brackets. The process of individual income tax reform continues in a number of states. If Georgia eliminated its top income tax bracket, 1998 revenues would decrease by approximately $571 million or 14.7 percent. Such a change would reduce the progressivity in the tax structure and would provide direct benefits to few low-income taxpayers (Table 7). However, if such a measure stimulated growth within the state, those individuals might benefit indirectly from an increase in the number of jobs available to them.

Option #4: **Eliminate the state income tax entirely**

At least one candidate suggested this option. During fiscal year 1997, individual income tax collections in Georgia totaled more than $4.7 billion or 23.1 percent of general revenue. This amount represents a growth of more than 11 percent from the fiscal year 1996 levels, a direct result of the current growth and prosperity the state is experiencing. Although a multitude of alternatives exist for elimination of the individual income tax, this paper considers the following three alternatives: (1) eliminate the tax in one year, with no replacement of the tax; (2) eliminate the tax, and replace the revenues with an increase in the sales tax; and (3) eliminate the tax over a 10-year period with replacement of revenues with a sales tax increase. To see the magnitude of such a tax cut, consider that the most recent cut in income taxes amounted to $205 million, and the elimination of food from the sales tax amounted to $545 million and was phased in over four years.

A. Eliminate the tax and not replace the lost revenues

Another way to see the magnitude of such a tax cut, is to consider alternative cuts in state expenditures. If the expenditures cut is spread evenly throughout the state's budget, all areas would receive a 22.8 percent cut, with the largest dollar cuts affecting education, public welfare, and highways. For 1997, reducing the largest expenditure category (education) by the entire amount of the individual income tax collections would cut primary and secondary education funding by over 53 percent. Finally, if we begin with the smallest departments and eliminate them first, we completely eliminate 32 of the 35 departments, leaving only the State Board of Education, the University System of Georgia, and about 70

percent of the Department of Medical Assistance. Table 9 shows a list of the departments that would be eliminated and the amounts of their expenditures for 1997.

Table 9. Departments Eliminated due to Elimination of Individual Income Tax
Based on Fiscal Year 1997 Actual Expenditures and Tax Collection

Budget Item	Amount
Soil and Water Conservation Commission, State	$2,000,042
Teachers' Retirement System	3,558,409
Defense, Depart of	4,220,833
Public Service Commission	8,266,725
Banking and Finance, Dept of	9,189,889
Workers' Compensation, State Board of	10,471,248
Law Department of	11,777,309
Public School Employees' Retirement System	14,212,500
Insurance, Office of Commissioner of	14,553,644
Labor, Department of	19,483,133
Veterans Service, Department of	19,586,048
Industry, Trade and Tourism, Department of	20,001,204
Audits and Accounts, Dept of	20,475,526
General Assembly	22,175,658
Secretary of State, Office of	29,299,731
Governor, Office of	29,921,688
Forestry Commission, State	34,983,238
Agriculture, Dept of	40,975,755
Administrative Services, Dept of	41,378,201
Community Affairs, Dept of	47,580,514
Georgia Bureau of Investigation	48,177,543
Judicial Branch	83,818,558
Revenue, Department of	94,572,233
Natural Resources, Department of	101,991,280
Public Safety, Department of	117,680,477
Juvenile Justice, Department of	148,972,021
Student Finance Commission, Georgia	200,847,284
Technical and Adult Education, Department of	291,379,431
Transportation, Department of	351,132,314
State of Ga. General Obligation Debt Sinking Fund	621,465,791
Corrections, Dept of	715,130,799
Human Resources, Department of	1,167,664,118
Medical Assistance, Department of*	407,834,176
Total	$4,754,777,320

*Total expenditures for this department for 1997 were $1,309,571,316, which would mean that 31 percent of those expenditures would be eliminated.

Although a reduction in state government of this magnitude might be desirable in the long term, the state's economy would suffer significantly if such cuts were made in one year. For example,

unemployment would increase since resources currently employed by the state that would be "freed up" would not be automatically employed within the private sector.

B. Replace the individual income tax with an increase in the state sales tax

The state's sales tax rate is 4% and has been at that level since 1989. Based on research by Bahl and Hawkins (1997), we estimate that the state sales tax would need to increase from the current level of 4 percent to 10 percent to replace the revenue that would be lost from elimination of the state individual income tax.[3] Such a high state sales tax rate is significantly out of line with the other rates throughout the nation. The highest state sales tax rate, 7 percent, is in use in only two states--Mississippi and Rhode Island. The average rate in the U.S. is 5.2, which is almost half the rate needed under this scenario.

C. Phase-out the individual income tax over a 10-year period

Such a phase-out offers the following benefits over the first two alternatives: (1) the change would occur more slowly, which would produce less shocks within the economy; and (2) legislators and their constituents would have more time to evaluate the effects of totally eliminating the tax to determine whether a total elimination of the tax is in the best interests of the state. The phase-out could begin with eliminating the 6 percent bracket (see above), with elimination of other brackets throughout the 10-year period. In the initial year, this plan would reduce individual income tax revenues by approximately 15 percent. Although this plan would be simple to implement, the phase-out would not occur as smoothly as a flat percentage reduction in rates each year. Another problem is that eliminating the top bracket would reduce progressivity within the individual income tax structure and would not benefit over 20 percent of Georgia's taxpayers--those taxpayers with the lowest taxable incomes.

Another approach is to reduce all tax rates 10 percent annually, i.e., reduce the top bracket by 0.6 each year and the lowest bracket by 0.1 each year. Some advantages of this system are that it reduces the income taxes of all taxpayers, the plan is easy to explain, and the calculations are simple. Over the ten years of phase out, there will be growth in revenue that can be used to make up the revenue lost from the income tax. However, at the end of the 10 years, the state will have less revenue by the amount that the income tax would have generated. Table 10 shows tax revenue for each year

[3]In all probability, however, consumers would shift even more of their purchases away from taxable consumption, resulting in the need for an even higher level of sales taxes.

with the income and with a phase out. We assume that tax revenues will grow at the same average annual rate as for the past 10 years, i.e., 8.24 percent for the income tax and 6.00 percent for other tax revenue. Because the assumed growth of income tax revenue is greater than the growth in other tax revenue, the lost revenue at the end of the income tax phase out is a larger percentage of total tax revenue at the end of the period than at the beginning (47.7 percent versus 45.1 percent.) The calculations in Table 10 should be considered as illustrative since they are based on very crude forecasts of future revenue.

Table 10. Phase Out of Income Tax
(in millions of dollars)

	Retain Income Tax			Phase Out Income Tax			Lost Revenue	
Year	Income Tax[1]	Other Tax	Total Tax	Income Tax	Other Tax	Total Tax	Total	As a Percentage of
1997	$4,741	$6,157	$10,898	$4,741	$6,157	$10,898	$0	0.0%
1998	4,926	6,526	11,453	4,412	6,526	10,938	514	4.5%
1999	5,332	6,918	12,250	4,220	6,918	11,138	1,112	9.1%
2000	5,770	7,333	13,103	3,966	7,333	11,299	1,804	13.8%
2001	6,245	7,773	14,018	3,642	7,773	11,415	2,603	18.6%
2002	6,759	8,239	14,999	3,238	8,239	11,477	3,521	23.5%
2003	7,316	8,734	16,049	2,743	8,734	11,477	4,573	28.5%
2004	7,918	9,258	17,176	2,144	9,258	11,402	5,774	33.6%
2005	8,569	9,813	18,383	1,427	9,813	11,240	7,142	38.9%
2006	9,275	10,402	19,677	579	10,402	10,981	8,696	44.2%
2007	10,038	11,026	21,064	0	11,026	11,026	10,038	47.7%

[1]Based on effect of change in income tax code for personal exemptions in 1998.

Source: 1997 data from http://www.census.gov/govs/statetax/97tax.txt; subsequent years, calculations of the authors.

About the Author

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